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Iran: The Shah's Lending Binge Dec 74 74-15

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Iran:
The Shah's Lending Binge

KEY JUDGMENTS

The Shah's massive financial commitments[1] -- US $6.3 billion so far in 1974 – are geared to the following:

- accelerating Iran's industrialization through financial tie-ins with Western suppliers of advanced technology and equipment,
- acquiring supplies of domestically short raw materials,
- cultivating markets for Iran's non-oil exports,
- promoting stability in neighboring countries and improving political ties with old adversaries, and
- promoting Iran's influence and the Shah's image as a world leader.

Iran should match this year's $8 billion surplus in 1975[2] when, as outlined by the budget, it plans to lend and invest $2.6 billion. Major candidates for future financial commitments are

- large industrial nations such as Japan and Italy, as well as small ones such as Denmark;
- the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD);

1. Throughout this memorandum the term ***financial commitments*** comprises official bilateral and multilateral obligations expressed in an agreement or equivalent contract undertaken by the Shah or his representatives.
2. The Iranian fiscal year, which begins on or about 20 March, applies to budgetary and balance-of-payments data used in this memorandum.

Note: Comments and queries regarding this memorandum are welcomed. They may be directed to [redacted] of the Office of Economic Research, [redacted]

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- a sprinkling of African countries and other LDCs;

- some Indian Ocean states such as Bangladesh and Indonesia;

- Romania and possibly other less doctrinaire Communist countries; and

- the United States -- a prime target for equity investment.

Iran's ability to spend more quickly than other oil producers will result in continued rising imports and gradual erosion of the country's surplus revenues. Indeed, unless oil prices are raised, Iran's balance of payments could be back in the red by 1979. Thus, the Shah will be under pressure to

- intensify his hard-headed lending and investment policy -- equity and growth-producing project commitments rather than concessionary long-term loans -- and

- hasten the development of export alternatives to oil -- natural gas, petrochemicals, and copper.

DISCUSSION

Financial Commitments in 1974

1. Iran's recent burst of loan offers switched the country overnight from a net borrower to the Middle East's largest lender in 1974. Unlike neighboring oil-rich states, which have piled up billions in foreign banks, Iran until this year borrowed heavily from abroad. The sharp rise in oil prices in 1974, however, changed this situation, and by October 1974 Iran's foreign assets had grown from only $1.3 billion in 1973 to $6.3 billion, paving the way for the Shah's mammoth lending and investment activity. As opposed to only scant lending that aver- ed some $30 million annually in previous years, the Shah has committed almost $6.3 billion this year.

2. The pace and variety of Iranian financial commitments -- firmly controlled by the Shah -- contrast with the still largely traditional mode of investment by other Middle East countries. Iran's foreign loans rival those of major industrial countries. The sequence of his commitments to some 17 countries, th IBRD, and the IMF has been as follows:

- in March and April $200 million in IBRD bonds were purchased and $1 billion in credits offered to India;
- May and June saw loan commitments of $850 million to Egypt, $150 million to Syria, and $1 billion to France;
- two major agreements followed in July. $580 million for Pakistan and $1.2 billion for the United Kingdom (Iran also bought a one-fourth interest in West Germany's Krupp steelworks);
- in August, $700 million was extended to the IMF and $63 million in additional credit was made available to Pakistan;
- in September and October, Iran provided a $100 million loan for Peru, purchased $150 million worth of additional IBRD bonds, lent Jordan $7.4 million, and gave Afghanistan $10 million; and
- during the first half of November, Iran extended credits of $100 million to Poland and $67 million to Sri Lanka.[3]

3. For more details on Iran's financial commitments this year, see Table 1.

Table 1

Iran: Financial Commitments
1 January-30 November 1974

	US $	Comments
Afghanistan	10 million	Grant on 22 October to conduct feasibility studies on various road, rail, and industrial projects outlined in an economic protocol signed on 28 July. Eventual assistance for these projects could amount to one or more billion dollars.
Cyprus	0.1 million	Grant to assist war victims.
Egypt	850 million	Protocol signed in Tehran on 25 May. Includes $400 million to finance Egyptian portion of joint ventures; $250 million "soft term" credits for Port Said reconstruction; $100 million suppliers credit for purchase of Iranian machinery and equipment, buses, and various consumer goods; and $100 million to assist Egypt's industry.
Ethiopia	0.1 million	Grant for drought relief in February.
France	1 billion	Agreement announced on 27 June for interest-bearing advance payments over three years on an estimated $4 billion to $5 billion in projects to be built by French firms.
India	Possibly 1 billion	On 25 June, the Shah referred to a $1 billion aid package for India. Assistance includes $300 million for developing iron ore deposits and $60 million for alumina development agreed to in March. Remaining credits probably are for financing 70% of oil purchases for five years. Repayment in five years, after a five-year grace period, at 2-1/2% interest.
IBRD	350 million	Purchase of 12-year bonds at 8% interest.
IMF	700 million	Loan commitment in August. Iran will be repaid in eight semiannual installments, starting in 1978 with interest at 7%.
Jordan	8 million	Concluded in late 1973 or early 1974. Includes $5 million for educational projects to be repaid over 20 years at 2% interest and $3 million in trade credits. Interest on both credits will be applied as grants to a special fund for other development projects.
	7.4 million	Credit extended in October 1974.
Morocco	30 million	Agreement signed in May 1974 for agricultural development credit. Repayment in 12 years, after a six-year grace period, at 4% interest.

Table 1

Iran: Financial Commitments
1 January-30 November 1974
(Continued)

	US $	Comments
Pakistan	580 million	Commitment made on 12 July to provide credit for balance-of-payments and development assistance repayable in five years after three-year grace period, at 2-1/2% interest.
	63 million	Loan agreement in August for industrial projects, including joint ventures. Terms probably are the same as for the July commitment.
Peru	100 million	Part of a syndicated loan in October for construction of Transandean oil pipeline. Repayment in seven years with a four-year grace period, with interest believed to be at commercial rates.
Poland	100 million	Credit assistance in constructing paper plant in Poland; signed on 15 November.
Senegal	8.5 million	Joint communique issued on 16 June. Includes $4 million for loans, $3 million to expand industrial free zone in Dakar, and $1.5 million for irrigation project; loan at 2.5% interest.
Sri Lanka	67 million	Agreement in early November 1974 to provide $27 million credit for fertilizer plant, $32 million advance on exports to Iran, and $8 million balance-of-payments assistance.
Sudan	65 million	March 1974 agreement to cover two-thirds of the cost of oil purchase from Iran of 12.5 million barrels in 1974. Repayment after five years at 5% interest.
Syria	150 million	Letter of intent signed 27 May for low-interest credits for fertilizer plant, agro-industry, and other development.
Tunisia	5 million	Agreement signed on 9 January for loan to build Sadi Salam Dam; repayment over 20 years at 2% interest. Interest on loan may be applied as gift to special development fund.
United Kingdom	1.2 billion	Agreement signed 22 July for disbursal over three years, after which repayment will be made in five years at commercial rate of interest.

3. To date, the deals hardly have been philanthropic. More than one-half of the amount committed by the Shah calls for repayment on near commercial terms. His largest loans -- to the United Kingdom and France -- are strictly commercial, yielding returns comparable with Eurodollar rates. Moreover, the IBRD bonds and loans to the IMF bring fairly high rates of 8% and 7%, respectively. Only 1% of the $3 billion in commitments to the LDCs consists of grants and loans with concessionary repayment terms of 20 or more years and less than 2-1/2% interest. The large loans to India and Pakistan, for instance, are repayable within 10 and 8 years, respectively. In contrast to the Shah's rather hard terms, the Arab countries have been quite liberal, frequently providing grants to the LDCs or letting them repay loans over 10-40 years at rates varying from 0% to 8%.

4. The Shah has kept as close a rein on the $100,000 grants to Ethiopia and Cyprus as on the huge credit commitments to the United Kingdom and France. Ambassadors, special missions abroad, and the Ministry of Economics and Finance (in which an undersecretary to handle investments and foreign aid has been established) advise the Shah, and the Council of Ministers and the Iranian legislature approve the loans. Formalities apart, however, the Shah holds the ultimate lending power, which he uses for his political-economic strategies.

Objectives of the Program

5. A primary objective of the loan program has been to speed up the industrialization under way in Iran. By advancing $1 billion to France for equipment on order, the Shah hopes to get priority treatment in supply and installation of a major nuclear energy industry as well as assistance in expanding steelmaking capacity. To maintain the industrial development pace and to assure supplies of machinery and critically needed raw materials, the Shah has provided credits to the United Kingdom, India, and others. The investment in Krupp opens to Iran the technology of this West German industrial giant.

6. These deals -- and most of the credits to the LDCs -- are also designed to strengthen markets and prices for Iranian oil and to provide new outlets for non-oil exports. Terms of the credits offered to India, for instance, are linked to oil sales at prevailing high prices and provide for Indian purchases of Iranian industrial goods. Similarly, the agreement with Egypt is tied to purchases of Iranian machinery, buses, and other goods that probably could not stand the test of world market competition. Cairo also has agreed to give Tehran access to a Mediterranean port, enabling Iran to broaden its sales to North African countries and Europe. In his current efforts to get better trade considerations from the EC, the Shah

is supported by Denmark, which expects Iranian credits, and by West Germany, which has received Iranian investment and large orders for capital equipment.

7. Finally, the loan policy of the Shah reflects a strong penchant for security and for influence beyond Iran's borders. By holding out the prospect of huge project credits to Afghanistan, the Shah hopes to weaken the Soviet grip there and to influence decisions on the controversial border problem between Afghanistan and Pakistan. Current aid outlays to Islamabad are geared to projects improving economic conditions in the Baluchistan area, where discontent and threat of separation are regarded with fear by the Shah. Aid offers to Egypt, Syria, and Jordan are aimed at minimizing reactions to Iran's relations with Israel as well as to dispose these Arab countries to accept the growing Iranian influence in regional affairs. By plying New Delhi with badly needed credits, the Shah seeks to improve political relations with India and to extend his influence in the Indian Ocean area. The small credits extended to African states bear the imprint of the Shah's influence peddling and a desire to fend off criticism as the architect of high oil prices. The Shah is especially sensitive on the oil price issue and is anxious to be portrayed as a responsible world leader. To this end, he has offered financial assistance to the international organizations, extended his own program for a "neutral oil fund," and provided major financial assistance to industrial countries.

Foreign Lending and the Balance of Payments

8. Iran's balance-of-payments surplus this year and in the next few will afford the Shah a comfortable cushion for additional lending and investment. Even after the large deals so far this year, Iran's surplus amounts to more than \$8 billion. Although rising imports will diminish the surplus, the amounts available for lending will be substantial for several years. Oil payments of \$20.6 billion in 1974 will quadruple those last year. The increase stems almost exclusively from price hikes in January and from arrangements that give Iran the equivalent payment of gains achieved by Persian Gulf producers through increased participation. Total foreign exchange receipts of more than \$22 billion outrun imports by a considerable margin and easily accommodate this year's unusual debt prepayment of \$1.6 billion and loan and investment disbursements of \$2.4 billion, as follows:

	Million US $
France	300
India	140
IBRD	350
IMF	700
Pakistan	250
Peru	100
United Kingdom	400
Fried. Krupp GMBH, West Germany	60
Grumman Corp., US	75

9. This year's balance-of-payments surplus of $8.4 billion (see Table 2) would be larger if it were not for an unusual surge in imports. Foreign exchange payments for imported goods and services this year will jump 60% -- more than double earlier rates -- with possibly one-third due to price rises. The volume of this year's imports reflects the 40% real growth under way in the economy and the efforts to stem inflation. To combat inflation, Iran has opened the import floodgate on a wide variety of domestically short items such as cement, wood, newsprint, meats, and other consumer goods. Wheat imports, for instance, are running nearly double last year's level, and sugar imports are likely to be at record levels. At the same time, purchases of military hardware have risen sharply as

Table 2

Iran: Balance-of-Payments Projections

Million US $

	1974	1975	1976	1977	1978	1979
Current account	**12,950**	**11,755**	**9,300**	**6,655**	**3,120**	**-2,060**
Oil revenues	20,600	21,200	20,650	20,650	20,650	20,650
Other exports and services	1,750	2,775	4,020	5,375	6,870	8,040
Of which:						
Government investment income	500	1,000	1,800	2,600	3,300	3,700
Total revenues	22,350	23,975	24,670	26,025	27,520	28,690
Less imports and services	9,400	12,220	15,370	19,370	24,400	30,750
Capital account	**-4,570**	**-3,220**	**-1,600**	**620**	**810**	**720**
Utilization of foreign loans	180	220	....	....	....	....
Debt service	-750	-370	-300	-260	-180	-160
Debt prepayment	-1,600	-470	....	....	....	....
Loan disbursements	-2,400	-2,600	-1,300	....	....	....
Loan repayments	....	....	....	880	990	880
Balance of payments	**8,380**	**8,535**	**7,700**	**7,275**	**3,930**	**-1,340**

defense spending jumped by two-thirds. Accelerated developmental spending -- up by more than one-third to some $3.4 billion -- also has contributed to the import increase.

10. In a few years, Iran's import growth, estimated at about 26% yearly,[4] will begin crowding the Shah's oil earnings and narrowing his foreign reserve surpluses. At current output and revenue per barrel, Iran's oil receipts will amount to roughly $21 billion annually, and, by 1979, Iran's balance of payments should be back in the red. Considerations such as these influence the Shah's current hard attitude on oil prices and his judgments regarding lending and investing. While keeping a part of his reserves in fairly liquid types of short investment in the United States and Europe, the Shah is banking heavily on project-tied credits and a massive domestic push to increase and diversify the country's export potential.

Foreign Lending and Domestic Development

11. The boom in oil revenues led to an immediate hike in domestic spending plans. Government expenditures for economic development reportedly are to double during the 1973-77 plan period. An estimated $30 billion will be added to the original total budget of $49 billion. Allowing for outlays in 1973, some $67 billion remains programmed to be spent during 1974-77 (see Table 3) The major share of the expenditures will be reflected in foreign purchases. Some $4 billion to

Table 3

Iran: Estimated Government Expenditures in the Fifth Plan (1973-77)

Billion US $

	Original Plan	Additions	Revised Plan
Operational	26	8	34
Developmental	23	22	45
Total	49	30	79
Of which:			
Defense	17	8	25
Less expenditures in 1973			12
To be spent 1974-77			67

4. An import growth rate is predicated on past trends and plans for expansion of about 15% yearly and inflation of nearly 10% yearly.

$5 billion will go for purchase of nuclear reactors and other industrial facilities from France. Loans such as those to Paris and London illustrate how Tehran is using its foreign lending to promote domestic development. Grants to foreign institutions training Iranian managers for industry and, in the defense area, to firms such as Grumman Aircraft are being used to contribute to Iran's defense potential.

12. The revised spending plan also zeroes in on the export sector. Some $5 billion instead of $3 billion now is slated for investment in oil-related industries during 1973-77 in an attempt to move rapidly toward exports of oil products and petrochemicals, the latter yielding an eightfold price advantage over crude oil sales. Iran plans to divert one-fifth of crude oil output to production of refined products, part of which will fuel new petrochemical facilities at Bandar Shahpur, Kharg Island, and Shiraz.

13. Iran also plans to make more use of its gas reserves -- possibly the world's largest -- by expenditures on additional pipelines and liquefaction plants to facilitate exports to the USSR and Western Europe, respectively. Funds also are being set aside to expand copper exports. An ambitious development program, managed by Anaconda Copper, is well under way with the goal of making Iran the world's seventh largest producer. The Shah is increasing steelmaking capacity, which could make some contribution to exports. In support of these projects, large sums are being poured into new roads, port facilities, and powerplants.

Targets for the Future

14. Following the enormous loans to the United Kingdom and France that are secured by future exports, the Iranian Premier, Amir Abas Hoveyda, stated: "We are currently engaged in several negotiations of this type and some are nearing fruition. We do not exclude any industry or any country." Japan could be the next because it is the leading market for Iranian oil and a major source of advanced technology. Italy, once rebuffed by the Shah as politically insecure, may be reconsidered for a major loan to secure help for Iran's industrial buildup. Smaller West European nations, such as Denmark and Greece, also are on the list of eligible recipients. Indonesia and Bangladesh head the list of Indian Ocean countries likely to receive Iranian credits in the near future. The list could expand, however, as the Shah recently pledged to assist any littoral state in constructing fertilizer facilities. He also is expected to make additional loans to the IMF and to purchase an added $150 million in IBRD bonds. Apart from these essentially commercial dealings, the Shah undoubtedly will dole out small concessionary credits to politically favored LDCs -- probably Zaire, Lesotho, Niger, and Tanzania -- and

a few outright grants, including an expected $150 million contribution to a special fund for the LDC's.

15. Beyond government-to-government loans, the Shah has a strong appetite for direct foreign investment. "We are not going into the real estate business or buying any restaurants in Las Vegas, but our intention is to make serious and wise investments in foreign corporations ... more of the kind we have made for instance with Krupp of Germany." He reportedly has his eye on investments in other West German firms such as Bayer and Volkswagen as well as in such US companies as Ashland Oil, a Union Carbide affiliate, and arms producers such as Raytheon and Hughes Aircraft. A joint Iranian-US holding company for such military ventures was mentioned by the Shah's military representative to the United States early this year. Additional direct loans to private firms also may be in the offing; at least one has been made to a US company -- Grumman Aircraft. Finally, Iran probably will expand its financing of joint ventures in third countries, promoting in particular the building of refineries to use Iranian oil and the development of mining and agricultural projects, as in India, which could serve Iranian needs. Iranian investment policy is likely to show growing sophistication as a result of the widened experience of present personnel and the availability of foreign advisers. A large number of European and US banks have opened branches in Iran, and representatives of international investment firms are moving to take advantage of the expanded money market. The US firm of Merrill Lynch, Pierce, Fenner, and Smith, for instance, recently opened offices in Tehran, where, in addition to training aspiring Iranian brokers, it may assist the government with its investments.